RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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January 9, 1991 **LETTER 1060**

Dec. 28 DJIA 2629.21; PTI 3154; A-D Ratio -16.88
Jan. 4 DJIA 2566.09; PTI 3144; A-D Ratio -16.89
Dow Yield: 4.02%; Dow P/E: 13.4; DowPow: -798
Dow 30-MA: 2597; Dow 200-day MA: 2686
Dow Book Value: 1276; PTI 89-day MA: 3183
Percentage of Undervalued Blue-chips: 24%

Budget Gap Soars by 62%

WASHINGTON, Dec. 23 (AP) — The Federal Government ran up a budget deficit of $48.1 billion in November, the Treasury Department reported Friday. The shortfall was 62 percent higher than in November 1989, and was attributed in part to the Persian Gulf buildup and a declining economy.

Combined with the October deficit, the imbalance for the first two months of the 1991 fiscal year totaled $79.5 billion, up 42.5 percent from the period a year ago.

WILL THERE BE WAR? Honestly, your guess is as good as mine. If there's war, what would the market's reaction be? It's hard to believe that the market hasn't already discounted the possibility of war. If war does occur, I would guess that there could be a quick sell-off, then a rally and stabilization -- with (surprise) the market selling off when the war ended. But what if there's no war? Another surprise -- if no war, I believe the market would do the unexpected and head down (in other words, the bear market would resume). There's an old market adage pertaining to war: "Buy on the cannons, sell on the trumpets."

TIME BOMB: The latest figure on the federal debt is $3.343 trillion. Exactly one year ago the debt was $2.925 trillion. This means that over the last 12 months the US has added a record **$418 billion** (an average of **$8.03 billion a week**) to the total federal debt. This is the **true deficit**, anything else is a lie (let's call it a damn lie).

Maybe this piece says it all. Like a Greek tragedy, the drama of the deficits unfolds. Rising government spending, compounding interest rates, and now, the Treasury must deal with slumping tax receipts (slumping because of the recession). Result: a 62% explosion in the federal deficit for November. You like Treasury bonds, notes and bills? Then you're in luck. Because there'll be an absolute avalanche of them coming out -- coming out as far as the eye can see.

FALLING: The economic statistics are portraying what the market knew a year ago. The leading indicators have declined for five consecutive months. Durable goods orders for the latest month dropped a shocking 10.5% (non-defense orders plunged 16.5%). Machine tool orders for the latest month fell 26%. Housing starts are at a five-year low. The Purchasing Agents' Index has sunk to 40.4, its sixth consecutive month of decline (anything under 50 denotes a contracting manufacturing economy). Is the economy falling apart? The Administration people tell us no. The statistics say yes.

THE MARKET: Often, after sifting through literally hundreds of pages of economic data, magazine articles, brokerage reports, advisories, etc., I think back to the words of William P. Hamilton (a famous Dow Theorist and the third editor of the Wall Street Journal).

Wrote Hamilton: "This is why the stock market barometer is so valuable. It makes little of cycles or systems, interesting and even well-grounded inferences or common fads. It uses them all so far as they are useful, together with every other scrap of information it is possible to collect. The market movement reflects *all the real knowledge available,* and every day's trading sifts the wheat from the chaff."

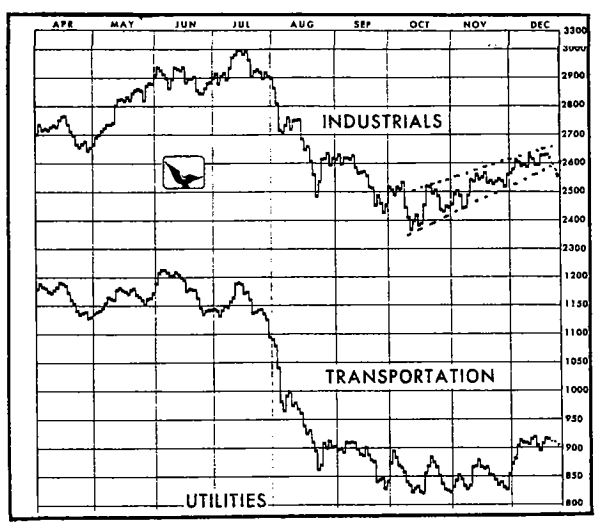
In other words, the story is in the averages and indices, and it's there that we should direct most of our attention and studies. The averages and the general market underwent a severe decline (breadth went into a semi-crash) during July to October. Near the lows, bearishness increased tremendously and the market became severely oversold.

An oversold market is one in which too much bearishness is built up over too short a period. Another way of identifying an oversold market is by the angle of its descent. If the angle is too steep, you know that the market is becoming oversold and that a period of sideways or rallying action is overdue.

And sideways and rallying action is exactly what we've seen in the markets since the October lows (actually, the Dow rally has assumed the form of a rising wedge). The D-J Industrial Average has so far corrected about 43% of its July to October losses. The Transportation Average has corrected considerably less (about 26%), while the Utility Average topped out on November 2 at 215.92. And it has been in a mild declining trend ever since.

Two of the best measures of what has occurred in the typical stock portfolio are seen in the broad **Value Line Composite** (composed of over 1700 stocks from all three exchanges, NYSE, AMEX, NASDAQ) and in my own breadth index -- the **All Market Index (AMI).**

Readers by now are familiar with **AMI**, an all-inclusive advance-decline line, which computes the combined daily advances and declines in all three exchanges. As seen on page 2, both the Value Line Composite and AMI have mounted feeble rallies off the October lows. This translates into a rather listless bounce on the part of any diversified portfolio of stocks (if you own a diversified list of stocks or a mutual fund you probably haven't been thrilled by this recovery so far).

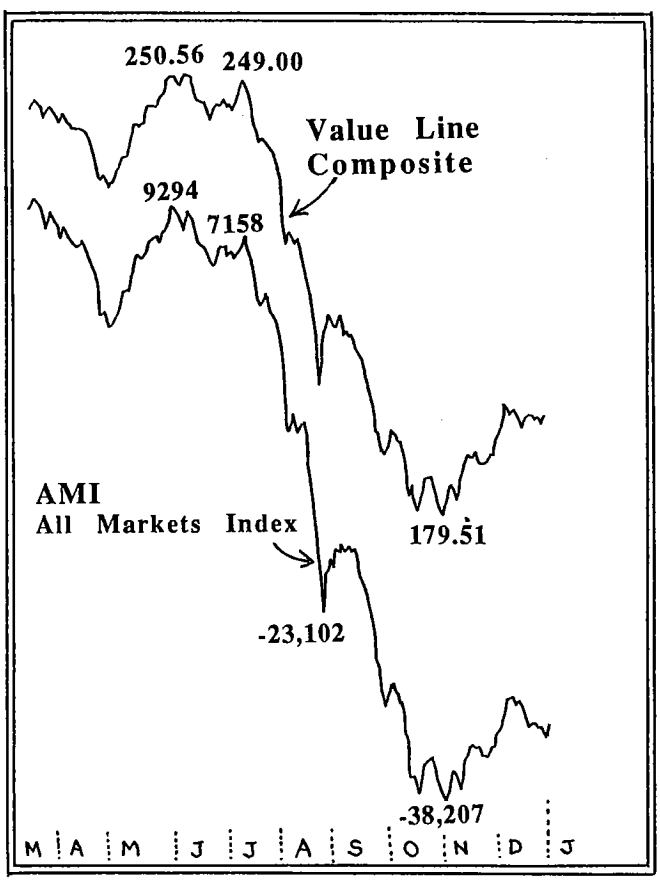


Disaster -- well, it had to happen some time, and today it did -- two of our fool-proof Mac SE-30 computers broke down, and that's the reason I had to use a different chart on page 1 (chart courtesy of *United Business Service*). And that's also why the usual PTI chart is missing from this page.

But here's the info -- the PTI has dropped to a new low of 3144, and the 89-day moving average of the PTI continues on its pronounced downtrend. By the way, note on the page 1 chart how the Dow has fallen out of the rising wedge pattern, typical bear market action. The Adance-Decline Ratio's unimpressive rise has ended and currently the A-D is less than a point from its extreme bear market low.

I wrote months ago that the July to October decline was too severe and too rapid. Following such a decline, I stated, the market has to both correct and to use up time. Why use up time? Because at the rate the July to October bear market collapse was going, the Dow would have fallen to zero within a year-and-a-half, and that was obviously not going to happen. Thus -- we have witnessed a weak rally; nevertheless, the rally has accomplished three things. (1) It has revived investors' hopes, and the ranks of the bulls have swelled. (2) It has used up time. (3) It has allowed the angle of descent in the averages to become much shallower.

Comment: On January 2, the*WSJ* published a rundown on the views of 40 "name economists." Of the 40, roughly three-quarters saw a declining (negative) GNP for the first six months of 1991 (which is hardly a tough call since the economy is already sinking). But get this -- only four of the 40 saw a declining GNP during the second half of 1991. In other words, 90% of the economists saw the economy turning up in the second half of 1991. Could nine out of 10 of these guys be right?



FALL IN U.S. PRICES, FIRST SINCE 1940'S, BEGINS TO SPREAD

START OF DEFLATION SEEN

Dollar Buys More, but Effects Are Called Worrisome for a Debt-Laden Nation

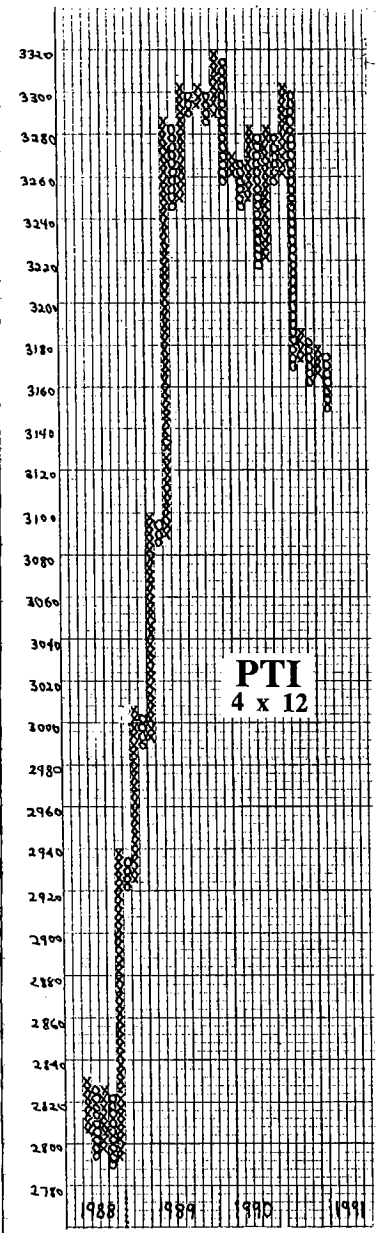
By LOUIS UCHITELLE

For the first time since the 1940's, falling prices have returned to the American economy, and they are starting to spread.

This new deflation is most visible in real estate. But prices are also dropping for steel, aluminum, plastics and other commodities used in manufacturing. And while prices are still rising for many things, like medical care, college tuition and legal services, recent data show the beginnings of deflation in some consumer products, like cars, furniture and kitchen appliances. The lower prices are often masked as rebates, sales and steep discounts; these are becoming fixtures rather than just special events.

The decline of some prices is beginning to show up in the Consumer Price Index, which measures the costs of a cross section of services and products. Not since 1960 has the United States entered a recession with that index rising by as little as it is today — averaging just 3.9 percent at an annual rate over the last three months, not counting energy prices.

Deflation, with its promise that the dollar will buy more each week than the week before, might seem a welcome experience for a nation accustomed to inflation — if it were not for the worrisome consequences. Principally, deflation causes problems for a nation burdened with debt, and debt in the United States increased to record levels in the 1980's.



DEFLATION: The headline is ominous. I've said before that DEBT'S WORST ENEMY IS DEFLATION. So if you're in debt (and most of the nation is), say "Hello" to your enemy. As this headline piece from the December 25 *New York Times* states, signs of deflation are now emerging. Deflation is painful regardless of how or when it appears. But deflation is disastrous when it appears in a nation that is up to its eyeballs in debt.

Why is deflation such an enemy of debt? Let me give you an example. You own a home and you have a fat mortgage on that home. But the times are inflationary, and as long as home prices are rising you don't mind making your mortgage payments. After all, you're investing in an asset that is increasing in value year after year.

But what about that same mortgaged home during a period of deflation? Ah, this is the other side of the coin. Here you're making payments on an asset that's declining in value. Furthermore, money is harder to make, the firm you work for is cutting back, your next door neighbor just lost his job and put his home on the market at a bargain price -- and well, you're wondering if it wouldn't make sense for you to dump your house and just rent.

Deflation means that money is worth more and is harder to get a hold of. In deflation, everyone is cutting back, everything is worth

less, people feel poorer, corporations, governments, states, citizens, can't meet their bills. Deflation is "unraveling time" for almost everyone.

But there's an exception to all this. The exception is the person (or business) that has cash and little or no debt. For them, deflation becomes "opportunity time." Why? Because deflation produces bargains. Deflation ultimately takes the price of "things" below known value. Deflation produces bargains in stocks, art, collectibles, apartment houses, homes, businesses, labor costs, you name it. The seeds of many great fortunes have been laid during periods of intense deflation. But as I said, there's a catch. During deflations you've got to have what no one else has -- and that's liquidity, commonly referred to as CASH.

But how much deflation are we in for? The truth -- I don't know whether we're seeing just a whiff of deflation, or whether we're heading for the biggest deflation since the 1930s. Nobody knows the answer to that. But I do know that this is a primary bear market, and I do know that there's still an awful lot of complacency around. On January 2, the CRB Commodity Futures (27 commodity futures) Index broke to 218.4, its lowest level in three years.

Most of the name-analysts are talking about "the low for this bear market coming in at around Dow 2300" or "maybe we've seen the low already." Maybe, maybe, but this bear has a lot of tricks up his furry sleeve, and if one of them is deflation -- then I'm afraid that Dow 2300 isn't going to fill the bill. No, if deflation really takes over, we're going to see a market a lot lower than Dow 2300 or even Dow 2000.

There's a contingent of analysts (some call them mystics) who are adherents of the "long wave" thesis, often called the Kondratieff Wave. This wave, they claim, is a sort of super-cycle wave that repeats every 50 or 60 years. The last time the big wave turned down was somewere during the late 1920s, and the wave continued down into 1932. Then the long-wave turned up, and it continued up into the 1980s. Around the mid-'80s, claim the wave adherents, the long-wave leveled off, only to turn down around 1987. The long-wave is now in the process of heading down in earnest.

Frankly, I've never known exactly what to think of the Kondratieff Wave theory. But I certainly don't poo-poo it, and I don't dismiss it. And I do wonder about it -- a lot. I do know that primary bear markets are international in scope. I've always known that. And I've been thinking -- is it just a coincidence that Soviet Russia is disintegrating at a time when the US is experiencing a primary bear market and (amazingly) actual deflation? Is it just a coincidence that the rest of the world's stock markets are down anywhere from 10% to 80%? Is it just a coincidence that the Mideast is a time-bomb, and that the US financial system (from banks to S&Ls to insurance companies) is shaky? And are we facing just a "mild, short recessionary period preparatory to new highs in the Dow" as most analysts seem to think?

Or are all the experts fated to be wrong? Is the long-wave finally turning down? Is a vicious and extended bear market being ushered in, and is the Dow heading for maybe 15 times its dividends or (Lord help us) even less?

As a point of information, at major bear market bottoms the Dow can sell for 15 times dividends. Dow dividends are currently $103.13. Assuming no dividend cuts, the Dow at 15 times dividends would sell for 1547. But during vicious or extended bear markets, dividends do get cut. And if sustained deflation enters the picture, then I can tell you that this bear market is going to be a hell of a lot different than the hopeful forecasts you read in the financial columns of *USA Today* or the *Wall Street Journal.*

At this juncture, there's a chart that I want to show my subscribers (page 2, on the right). It's a point & figure chart of my Primary Trend Index(PTI). This is a 4 by 12 graph, which means that each box on the chart equals 4 points and only rallies or declines of 12 points or more are depicted. In other words, this is a very concentrated picture of the PTI covering three years of action.

As older subscribers know, my PTI is a proprietary device. It's based on the daily movement of eight very fundamental "action-of-the-market" indices and averages. The PTI sometimes leads the market, sometimes it's a coincident indicator and occasionally it even lags. But a movement in the PTI, if it is persistent, invariably takes the market with it.

From its 1988 low, the PTI has formed what I call a "stilt formation." The stilt structure is obvious enough, but the fact is that the PTI has not corrected or declined in an important way since its 1983 low of 1520. Now 1520 is a long way down. The point to remember is that stilt formations (in any item) have a habit of breaking down. The PTI ran up in a stilt, then formed a very clear top during 1989-90. It is now in the process of breaking down.

On January 4, the PTI dropped to 3144, its lowest level since the 1989 peak. Obviously, I don't like the looks of what's happening on this chart. Let me put it this way -- if the decline in the PTI continues, it will surely take the market with it.

I'm paying particular attention to my PTI now because it's such a basic measure of the underlying strength or weakness of the market. I'm also watching the PTI because it's a device that is not seen by 99% of market practitioners. The PTI is proprietary, and I mean to keep it that way. Finally, I'm interested in the PTI because it's showing a picture that is very different from what I see and hear from other sources.

INVESTMENT POSITION: In time of war or national emergency, people tend to become patriotic. For this reason, a number of subscribers have asked me, "What's the patriotic thing for a investor to do here?" And I tell them, "The patriotic thing to do is to get 'safe' and fairly liquid." If you're solvent and liquid when this bear market nears its bottom you can help the nation and help yourself by buying stocks. In that way, you'll be doing your part to bring capital back to America's equity markets.

It's the people with cash who will turn this bear market around when it's near its final lows. On the other hand, if you're scared silly and loaded with losses when this bear market hits its low, you won't be doing yourself or your country a darn bit of good!

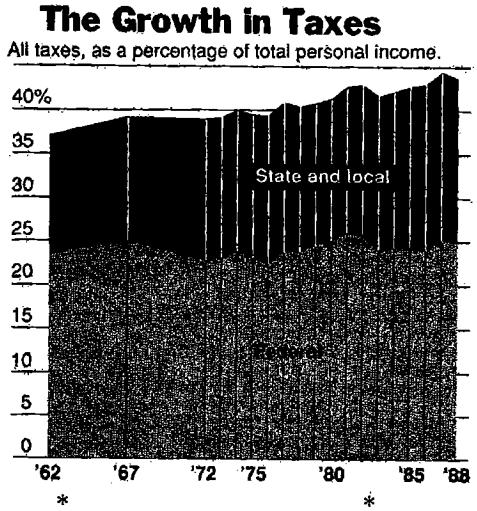
Cash is looking mighty attractive here. As stocks work lower, cash is worth more in that it buys an increasingly larger amount of stocks.

At the same time, hard currencies continue to do well. The German mark, the Swiss franc, the ECU, all of them are providing a much better yield than the dollar. For smaller accounts, the Mark Twain Bank in St. Louis will sell you CDs hedged in any currency you want. For larger accounts (over $250,000), the Swiss Bank Corp. with offices in the larger cities (Miami, NYC, LA) can provide you with expert service.

I receive a lot of requests for info on money market funds. At this point, I feel you should go for true safety, and this means a fund like the Benham Government Agency Fund (yielding 8% -- 1-800-4-SAFETY) or United Services Treasury Securities Cash Fund (1-800-US-FUNDS).

By the way, for a rating on your bank or S&L you can call my old friends at Weiss Safety Rating at 1- 800-289-9222. Also for $15, you can get a rating on your insurance company at the same number. For info on the best insurance products at the strongest insurance company, call Tina Baughman at 1-800- TAX-CUTS.

NOTES & QUOTES: They're talking about a possible $10 (ten!) billion deficit for California this year. What went wrong? Spending is going up while tax receipts to the state treasury are collapsing. This chart shows what's been happening to us poor slobs via local, state and federal taxes. Read our lips! Help!



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Speaking of taxes, *Money* magazine (Jan. '91) divides the states into three areas, the tax havens, the tax hells and states headed for trouble. Havens include Alaska, N. Hampshire, Fla., Wyoming, S. Dakota, Nev., Texas, Wash., Conn., and Tenn. Hells include D.C., N.Y., Mass., Wisc., Md., Hawaii, Utah, Idaho, Minn., and N.C. States headed for tax trouble include Ala., Calif., Maine, Mich., Miss., Penn., R.I., and Vt. Steve Gold, director of the Center for the Study of the States, says "There's so much pressure to raise states' spending that there's going to be a rising tax tide. Biggest pressure will come from federally ordered expansion of Medicaid, the exploding cost of upgrading education and the need for more prisons." Says the editor of *State Budget and Tax Law News*, "There are going to be budgetary problems beyond what we're thinking about now. It could mean widespread hiring freezes and layoffs when it is too late to raise taxes to cover the gaps."

* *

Real estate continues to be one of the nation's big question marks. Will it stabilize or will it continue to sink? New England is where economists are looking, and they are wondering whether New England real estate (weakest in the nation) will go into a Texas-style freefall or whether, hopefully, the worst has been seen. Says Ken Guenther of the Independent Bankers Assoc. of America, "Every major bank holding company in Texas essentially failed. That's not what's going to happen in New England. But there won't be a light at the end of the tunnel until real estate values stabilize." (Don't miss the piece on California real estate in the Dec. 31 issue of *Barron's* ; it's an eye-opener.)

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Economist Lacy Hunt states, "Fiscal policy is hopelessly out of sync with the economy." He notes that on top of the $21 billion of new federal taxes that will confront Americans starting now, 33 states will be hitting Americans for roughly $10 billion in new taxes. Russell comment: this marks the first time in history that the US has entered a recession accompanied by rising taxes for Americans (actually, we'll be swallowing one of the biggest tax increases in history!).

* *

I had to dig the following out of the *International Herald Tribune* (which, incidentally, is a terrific little newspaper): "55,000 US companies filed for bankruptcy from January through November, listing $64.1 billion in debts. That sum is equal to 1.1% of the GNP. Not since the Great Depression has the level even approached 1%."

* *

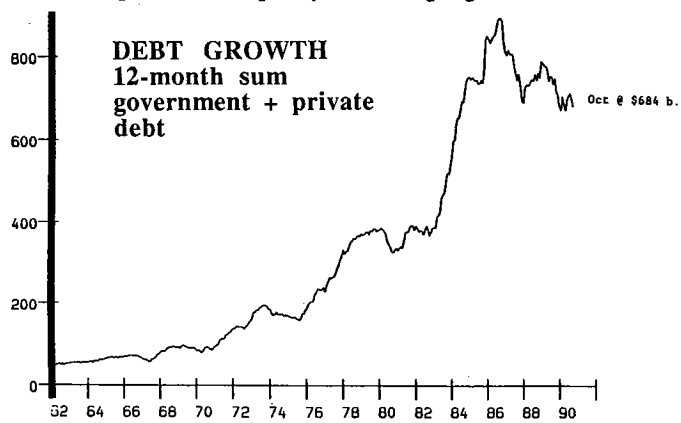
Many economists expect the usual good rebound when this recession ends. Not so, thinks the authoritative *Bank Credit Analyst*. The following is from their year-end "Outlook 1991" report: "US banks have 40% of their loans in real estate, and they are substantially under-reserved and unprepared for a continuation of the real estate debacle. Real estate was, of course, the main culprit in the collapse of most of the thrift institutions during the past three years and most of the banks during the 1930s. There is no quick fix available to reverse a major real estate deflation when there has been a lot of speculation and excess capacity.

"Japanese banking also is headed for a major contraction. In many ways, Japanese banking lies at the heart of the mania of the 1980s."

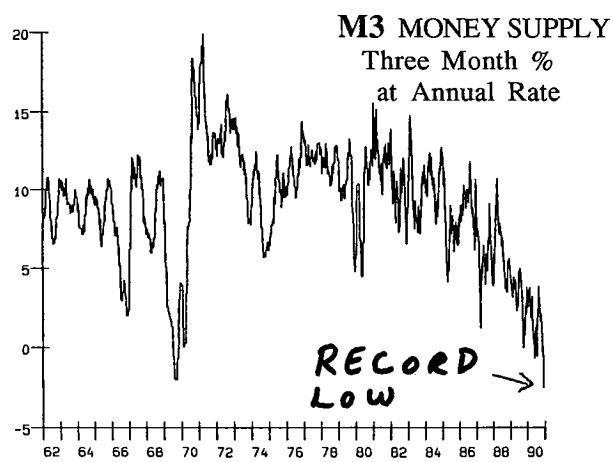
BCA continues: "Don't expect a repeat of the 1930s but the many similarities suggest that a painful stretch of deflation is ahead . . . We believe that the terminal phase of the supercycle we have known since the 1960s is over and that we have entered an entirely new era. There does not appear to be any credible reflationary levers left to the US authorities and that is why prospects for the early 1990s look grim. They always could take the Latin American route and end up like a lot of basket cases south of the Rio Grande. However, that is not a solution. The process of de-leveraging will extend for a few years as corporations, banks, thrifts, individuals and government at all levels try to become liquid simultaneously . . . The US has never experienced high private and public debt without a disorderly debt deflation spiral . . . We think the most likely outcome will be a prolonged period of very sub-par growth, with a slow, painful rebuilding of liquidity." (BCA, 1-514- 398-0653.)

* *

This chart from Ed Hyman's (*CJ Lawrence*) latest mailing shows the trend of total debt growth in the US since 1962. Note the declining trend. This is the re-liquefaction or de-leveraging process. It could go on for a long time as every segment of the nation attempts to build liquidity and savings again.



Everybody is waiting for the money supply to expand. It isn't happening. Ed Hyman tells the story. Writes Ed, "In early December, M3 declined a record -- $16 billion (M2 declined $12.9 billion). The decline was probably due to (1) no growth in Reserves, (2) the credit squeeze, (3) weak Christmas sales. Until the Fed starts to lift Reserves (i.e, ease aggressively) money growth is likely to remain weak."



Ed Hyman also points out a few facts about Congress' own budget. House of Representatives' budget for 1991 -- $635

million, up 20.5% over 1990. Senate's budget for 1991 -- $414 million, up 12.2% over 1990. This comes out to a cost of $4.14 million for each Senator, and $1.45 million for each Congressman. And I ask, "What the hell are these guys doing with our money?" Hyman's one word comment: "Outrageous."

* *

My old friend, Burt Dohmen (he writes the excellent *Wellington Letter*) predicted in a speech last August at the ISI Seminar that we are going into a global recession plus worldwide bear markets. At the time, most people thought Burt's view outlandish. In his latest report Burt writes, "The economy is now in the accelerating phase of the decline. The statistics over the next several months will shake up even the optimists . . . Lower interest rates will not do anything to change the situation. In fact, a lower prime rate will give banks even less incentive to lend money. The Fed has created conditions which are very difficult to reverse. But they'll at least be successful in one thing: zero inflation. However, the cost will be hundreds of billions of dollars." *(Wellington Letter,* 6600 Kalanianaole H'way, Honolulu, Hawaii 96825.)

* *

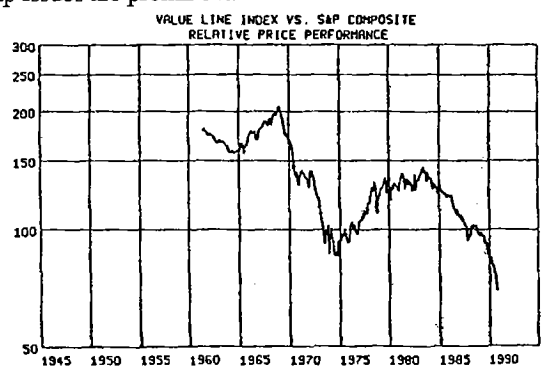
John Train, a long-time subscriber, has written many fine financial and Wall Street books. But a few weeks ago, John sent me a little book he put together entitled, "John Train's Most Remarkable Occurrences." (Harper Collins, $9.95.) The book is fabulously funny; it's a collection of unbelievable events -- all of them true.

Examples: Tapei -- A young Taiwanese man has written 700 love letters to his girl friend over the past two years trying to get her to marry him. His persistence finally brought results. A newspaper reported yesterday the girl has become engaged to the postman who faithfully delivered all the letters -- United Press.

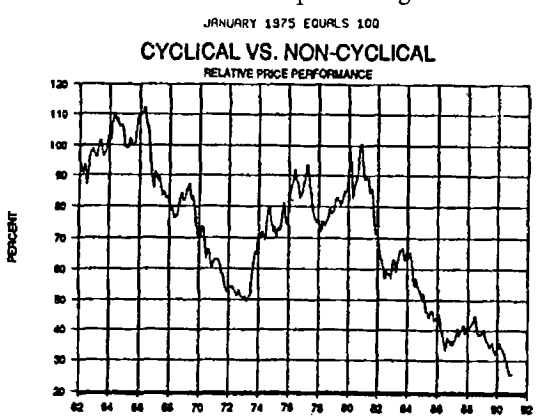
Prague -- Vera Czermak jumped out of her third-story window when she learned her husband had betrayed her. Mrs. Czermak is recovering in the hospital after landing on her husband, who was killed, the newspaper *Vercerni Pravha* reported today.

* *

This was supposed to be the year of the little stock. It hasn't happened. This chart shows the ratio of the Value Line Index to the S&P 500. Value Line is an unweighted index of 1700 assorted stocks while the S&P 500 is a weighted index of stocks where large cap issues are prominent.



At the same time a chart of cyclical vs. non-cyclical stocks shows that cyclical stocks have been underperforming for the last decade.



What this suggests is that when the next bull market starts, the cyclical stocks should be the big movers as they were from 1974 to 1981 (charts courtesy the *Contrary Investor,* Burlington, VT 05401).

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You think you know almost everything about Wall Street and the markets? Perish the thought. Nobody does. But there's one place where you can learn a heck of a lot more, and that's via the new addition of the Dunn & Bradstreet's Guide to $Your Investments$ for 1991. This 409-page paperback book is out in the book stores, it sells for $12.95, and it is written and updated by an old friend of mine, Nancy Dunnan.

In this well-written book, Nancy explains everything from bonds to real estate to investment letters to taxes to warrants to commodities. It's a real storehouse of information, and I recommend it. Nancy's a writing fool -- books, columns, magazine articles, TV appearances -- I don't know how she gets it all done.

* *

Are the sport team owners playing with potential bankruptcy? Get this -- 21 NFL quarterbacks now have contracts totaling $194 million. Half a dozen baseball players now get $3 million a year before next season's opener. The SF Giants spent $33 million to get three free agents. The Boston Red Sox paid $6 million for a pitcher who lost 18 games last year and they'll pay Jack Clark $2 million a year to play. Who pays for all this? The fans and the broadcasters. But be careful, CBS just lost $100 million on baseball, and they're not happy. All this skyrocketing pay nonsense puts pressure on ticket prices. One of these recession days, the public is going to go on strike and stay home. And the team owners are going to wonder how they got into this bidding mess.

* *

The year-end discussion of the market and the economy in *Barron's* (Dec. 24) was, I thought, their best ever. Bob Farrell of Merrill Lynch thinks the Dow could decline to as low as 1700 before the bear market is over. Bob notes that there was no big breadth explosion (buying stampede) off the October lows, of the sort that has signaled the start of every new bull market. Only one of the four analysts interviewed was bullish -- the other three thought that the Dow would finish around 2000 to 2300 to end the bear market. But none of the four were extremely bearish -- none, for instance, thought the Dow would go below 2000. The thinking was that this bear market would be on the long side timewise, but rather shallow. Russell comment: As you know, I think the bear market will be long and not necessarily shallow. The feeling I get here is that analysts are quite complacent and are mostly speculating as to whether the bear market is over and above all what stocks to buy.

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I have Marty Zweig's latest report, and as usual it's very interesting. Marty writes: "I'm no genius and above all I'm no crapshooter. I try to measure the risk and act accordingly." He states that his "regular indicators look good, telling me to be bullish. But the economy looks the worst I've ever seen it in my lifetime . . . and if the recession runs deep or extends beyond the first quarter of 1991 (which I think is likely) stocks won't do well longer-term . . . Moreover, the banks are unable or reluctant to make a lot of loans (because of so many bad ones outstanding), and that's killing the economy. In addition, the profit gains to banks because of the lower reserve requirements will be wiped out by increased FDIC insurance rates. So a great piece of bullish news may be rendered neutral . . . The ratio of Debt to GNP is out of sight. It's far above that prior to the past several recessions and is about equal to the 1929 level. The economy is choking on its own debt orgy. The danger of unwinding debt cannot be dismissed . . . The last has not been heard from that mountain of Debt." (*Zweig Forecast*, PO Box 360, Bellmore, NY 11710). So Marty Zweig would like to be bullish, but this debt-logged economy worries him.

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I have watched Saddam Hussein on TV over and over again. Here are my observations. Hussein's gestures and movements are (surprisingly) very "soft," limp-wristed, almost feminine. In that respect, Hussein reminds me very much of Hitler. Hitler always appeared limp-wristed and physically wishy-washy (remember his strange, tired, bent-elbowed Nazi salute?). I also note that in many

instances in the TV shows, Hussein is hugging and kissing some foreign ambassador or one of his officers (actually, I should say, one of them is hugging Hussein). But here again something strange is going on. When being embraced, Hussein invariably looks off into the distance. He NEVER looks at his embracer. This suggests to me that Hussein does not relate to people, he is (emotionally) in his own world.

I find that ominous. Remember Hitler attacking Russian against the advice of all his own experienced generals. Hitler was not in reality on his dire situation. And I don't think Hussein is either. I think Hussein will do what his "inner voice" tells him, regardless of what advice he gets from his generals (assuming one has the nerve to tell him what's really going on). Thus, it would not surprise me at all if Hussein picks the path of war. I even think that Hussein may firmly believe he can win the war. Put it this way -- I don't believe we're dealing with a normal man here. I don't believe Hussein is that much different (mentally) than Hitler was. (I might add that I have an autistic daughter, and in many ways Hussein's dreamlike and detached appearance remind me of autistic-like behavior -- autism is infantile schizophrenia, and the autistic person relates very largely to himself and to himself alone.)

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Champagne is a 135-mile area in France, and only grapes grown in that area can legally be called champagne. Champagne grapes sell for almost $6,000 a ton, four times the highest price paid for California grapes. With only 112 square miles of vineyards sustaining the $2.4 billion champagne industry, land and vineyards in the area are at a super-premium. Recently, two champagne producers were bought out by a third -- price $650 million!

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With currencies fluctuating wildly across the globe, large investors seem increasingly enamoured with gems as a store of value. On November 14, Robert Mouswad paid a record $12.76 million for a dead white (D color) flawless 101.84 carat diamond. It was the highest price ever paid at auction for any jewel. Meanwhile, at Christie's in Geneva, London dealer Laurence Graff paid $3.9 million for a pendant that contained a $3.18 million blue diamond. That amounted to $514,000 a carat, the highest per carat price ever paid for a blue diamond at auction.

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At the same time, other records were being set. The year 1990 saw more homicides in the USA than in any year in history. No less than 19 US cities set records for murder. NYC led with a record 2,200 murders, Wash. DC was second with a record 483 murders, Philadelphia ("City of Brotherly Love") was third with 525 murders, Dallas was fourth with 445. How were they killed? Firearms led with 11,832 homicides, cutting/stabbing was second at 3,458, blunt objects third at 1,128.Who killed whom?More than half of the victims knew their killers, and of these, 15% of the victims were related to the killers. Amazingly, only 13% were killed by strangers. One third of the killings were a result of arguments. Blacks fared badly. Homicide was the leading killer of blacks in the 15 to 24 year age group. One staggering result -- there are now more blacks in prison than there are in college.

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In his latest *Real Property Letter,* Adrian Van Eck describes in detail the great Florida land boom of the 1920s and wonders whether there isn't somewhat of a parallel in the collapse of the recent California real estate boom. Writes Adrian, "The stock market (1929) grabbed most of the headlines and later on it was the stock market crash that many people were to blame for the Great Depression. But looking back now, from the perspective of ever-so-familiar events unfolding in 1990, it is possible to ask whether or not the real estate crash in Florida and the tightening of credit by the banks -- both of which preceded the 1929 stock market crash -- may have played a much bigger role than observers realized at the time in leading up to and causing both the crash and the Depression. The question becomes urgent in light of what is suddenly happening to real estate in California." (*Real Property Letter,* PO Box 6640, Holliston, Mass. 01746).

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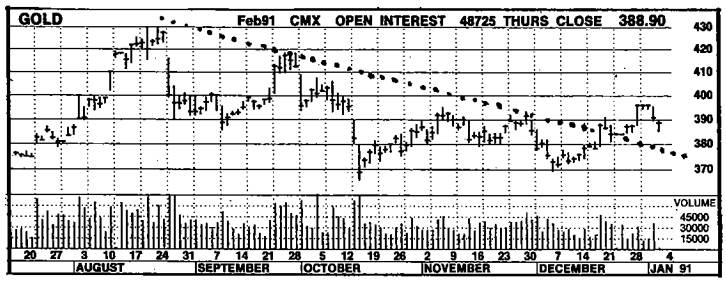
If the recession continues, eight states will have used up their unemployment insurance funds by mid-year, and by year-end 20 states will have exhausted their unemployment funds.

GOLD: There isn't a heck of a lot that I can say about gold here. The story is on this chart from that excellent publication, *Investor's Daily*. Here we see a long declining trendline in gold, a trendline that connects the August, September and November peaks. During late-December, this trendline was broken to the upside, and the February gold contract rallied to 396. Then, just when it looked as though gold was heading over 400 -- ka plunk, another disappointment for the long-suffering gold-philes. Nevertheless, gold is holding well in the face of definite commodity deflation. What's happening? Obviously, gold is marching to the beat of a different drummer. The drummer, in this case I believe, is the possibility of bankruptcies in all directions and a few major breakdowns in the financial system.



LATE NOTES: The economic news that emerges daily is really much worse than even the pessimistic economists expected. It "feels" as though the economy is falling off a cliff. Normally, the stock market discounts the future anywhere from six months to a year ahead. But the emerging news is so bad that it almost seems as if the news itself is driving the stock market down.

Of course, this isn't actually true. Remember, the July to October smash in the stock market was a killer for the majority of stocks and this can certainly be seen in the action of the breadth indices (see chart of AMI on page 2). So as I see it, the July to October collapse was a warning and a forecaster of the rotten news that is now surfacing. The fooler, of course, was that so many people were bullish at the time (remember the talk of a "soft landing" or "probably no recession at all"?) that they paid very little attention to what the stock market was telling them.

My PTI is now making new lows, the A-D ratio has broken below its feeble rising trendline, and the Dow has fallen out of its "rising wedge" pattern (a rising wedge, by the way, is a typical bear market-rally formation).

Everyone and his brother has been talking about the so-called "January effect." This was the market's tendency during January to rally the low-priced or more speculative shares, shares that had been knocked down at year's end. So far, the January effect has been notable for its absence.

Then there's the "January bellwether" syndrome. This thesis states that the first week in January typically sets the tone for all of January. And the entire month of January more often than not sets the tone for the rest of the year. At any rate, the first week in January this year was a minor disaster.

But I don't look at it exactly that way. I believe that during late December and during January, informed investors look out as far as they can see -- at prospects for the new year. If they like what they see, they accumulate stocks. If they don't like what they see, they head for the exits. So far, the exits are winning.

Another observation. I've noted that during bear markets, it's very usual for breadth (in other words, the action of most stocks) to hit its high for the year during January or certainly during the first quarter. Thus, my guess is that breadth will see its high this month.

It's clear to me that the bear market is now in its second (psychological) phase. This is the phase where stocks go down as they reflect deteriorating business conditions and declining earnings.

NEXT MAILING: January 23